

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Wiggins Analyst: Darrine Distefano Bill Number: AB 44

Related Bills: See Legislative History Telephone: 845-6458 Introduced Date: 12-04-00

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Disaster Loss Deduction/2000 Earthquake

SUMMARY

This bill would allow taxpayers special tax treatment, called disaster loss treatment, for losses sustained as a result of the earthquake that occurred in September of 2000 in Napa, California.

EFFECTIVE DATE

As an urgency bill, this special disaster treatment of losses applies to the taxable year of the loss, which may be 1999 or 2000, depending on whether the taxpayer is a fiscal or calendar year filer.

LEGISLATIVE HISTORY

AB 1X (Stats. 1997, Ch. X3) covered losses for the storms and floods of 1996-97. Also in 1997, AB 4X (failed passage at the Assembly desk), AB 94 (was amended to a gun safe credit), and SB 1X (failed passage on the Senate floor) would have covered losses for storms and floods of 1996-97. AB 2456 (Stats. 1998, Ch. 749) covered losses for the storms and floods of February 1998. AB 114 (Stats. 1999, Ch. 165) covered losses for the winter freeze of 1998-99.

SPECIFIC FINDINGS

Under **California and federal law** there are two types of losses that can be claimed by a taxpayer: a casualty loss and a disaster loss. A casualty loss occurs when property is destroyed as the result of a fire, storm, flood or other catastrophe. A disaster loss occurs when property is destroyed as a result of a fire, storm, flood or other natural event proclaimed a disaster by the President of the United States.

Under federal and state tax law, casualty losses that are not reimbursed by insurance are allowed to be taken as an itemized deduction in the year the casualty occurred. Alternatively, for a disaster loss the taxpayer may elect to claim the loss either in the year the loss occurs or in the year preceding the loss. This election allows the taxpayer to file an amended return immediately for the prior year. For state purposes, this election may be made prior to passage of any state legislation allowing special carryover treatment because California conforms to the federal election.

Both types of losses may produce a net operating loss (NOL). **Federal law** allows 100% of the NOL to be carried back for two years and carried forward for 20 years. In most circumstances, **state law** does not allow the NOL to be carried back and for the year 2000 allows 55% of the NOL to be carried forward for ten years.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald H. Goldberg

02/20/01

As with casualty losses, nonbusiness disaster losses not reimbursed by insurance are deductible under state and federal tax law to the extent each loss exceeds \$100. Total nonbusiness disaster losses are deductible only to the extent that the total loss amount for the year exceeds 10% of adjusted gross income.

California income tax law identifies specific events as disasters that are then allowed additional special carry forward treatment. That is, 100% of the excess disaster loss may be carried over for up to five taxable years, and if any excess loss remains after the five-year period, 50% of the remaining excess loss may be carried over for up to 10 additional years.

This bill would add the earthquake that occurred in September of 2000 in Napa, California, to the current list of specified disasters in the Personal Income Tax Law (PITL) and the Bank & Corporation Tax Law (B&CTL). Specifically, this bill would allow special disaster treatment of losses sustained as a result of that earthquake. The \$100 and 10% of adjusted gross income limitations in existing law would apply to disaster losses on nonbusiness property.

Current law allows the taxpayer to claim the disaster loss in the 2000 taxable year or elect to carry back the loss to the 1999 taxable year. The loss is claimed by filing an original or amended return by the extended due date for the year of the loss.

Policy Considerations

Beginning with the 2000 taxable year, the Net Operating Losses (NOL) amounts for both business and personal losses were increased to 55% and will increase again to 60% in 2002 and 65% in 2004. However, after the initial 5 years the disaster loss would be carried over at 50%. The author may wish to increase the 50% carryover to be consistent with the increased percentages for all other NOLs.

Implementation Considerations

Implementation of this bill would not significantly impact the department.

Technical Considerations

AB 1843 (Ch. 862) deleted all references to "income year" and replaced it with "taxable year" in the B&CTL. This bill still references "income year" under Section 24347.5 of the R&TC. The attached amendments would correct these references.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

Based on the discussion below, the revenue loss from this bill is as follows:

Estimated Revenue Impact		
For AB 44 (Napa Earthquake)		
(In Millions)		
Fiscal Year Impact		
2000-01	2001-02	2002-03
Negligible Loss	Minor Loss	Minor Loss

Negligible Loss = Less than \$250,000
Minor Loss = Less than \$500,000

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

Tax Revenue Discussion

The impact of this proposal will depend on the amount of disaster losses carried forward at 100% instead of 55% and the amount of carryover losses deducted in subsequent years.

The estimated losses were determined in several steps. First, it is assumed that the special disaster loss treatment provided for in this bill would be for losses sustained as a result of the September 2000 Napa earthquake. Second, the total amount of damages for the Napa earthquake was based on information from the Office of Emergency Services (OES). According to OES, damages were estimated to be approximately \$55 million, of which \$50 million is estimated to be for private property damages. It is estimated, based on historical data, that approximately 10% of damages will be reimbursed by insurance coverage. In total, the revenue loss over a period of a few years is estimated to be approximately \$1 million, with approximately 10% attributable to the B&CTL and the balance to the PITL.

This revenue estimate would stay the same if the bill is amended to conform the 50% carryover of disaster losses for 10 years to the 55%, 60%, 65% increases for NOLs.

OTHER STATES

The majority of states conform to the federal provisions that allow taxpayers to claim a disaster loss deduction on their state returns either in the preceding year or in the year of the loss.

BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 44
As Introduced December 4, 2000

AMENDMENT 1

On page 4, amend lines 34-37 as follows:

24347.5. (a) An excess disaster loss, as defined in subdivision (c), shall be carried to other ~~income years~~ taxable years as provided in subdivision (b), with respect to losses resulting from any of the following disasters:

AMENDMENT 2

On page 6, amend lines 24-37 as follows:

(b) (1) In the case of any loss allowed under Section 165 of the Internal Revenue Code, relating to losses, any excess disaster loss shall be carried forward to each of the five ~~income years~~ taxable years following the ~~income year~~ taxable year for which the loss is claimed. However, if there is any excess disaster loss remaining after the five-year period, then 50 percent of that excess disaster loss shall be carried forward to each of the next 10 ~~income years~~ taxable years.

(2) The entire amount of any excess disaster loss as defined in subdivision (c) shall be carried to the earliest of the ~~income years~~ taxable years to which, by reason of subdivision (b), the loss may be carried. The portion of the loss which shall be carried to each of the other ~~income years~~ taxable years shall be the excess, if any, of the amount of excess disaster loss over the sum of the net income for each of the prior ~~income years~~ taxable years to which that excess disaster loss is carried.

AMENDMENT 3

On page 7, amend lines 7-11 as follows:

(e) Any corporation subject to the provisions of Section 25101 or 25101.15 that has disaster losses pursuant to this section, shall determine the excess disaster loss to be carried to other ~~income years~~ taxable years under the principles specified in Section 25108 relating to net operating losses.

AMENDMENT 4

On page 7, amend lines 19-20 as follows:

return (determined with regard to extension) for the ~~income year~~ taxable
year in which the disaster occurred.